**Introduction to schemes of arrangement**

This element looks at some of the key attributes of schemes of arrangement under Part 26 CA 06 in the context of takeovers.

**What is a scheme of arrangement?**

A scheme of arrangement is a highly flexible tool which a company may use for a range of purposes, including returning capital to shareholders, reorganising a corporate group and in an insolvency context.

A scheme of arrangement is a procedure governed by Part 26 (ss.895-901) CA 2006 which involves the court.

A scheme of arrangement occurs where a compromise or arrangement is proposed between either:

* (a) a company and its creditors (or any class of them); or
* (b) a company and its members (or any class of them).

One of the most common uses for a scheme of arrangement is a takeover.

In simple terms, in a takeover by way of scheme, the target company enters into an arrangement with its own shareholders which results in its shares being transferred to the bidder which pays consideration for the shares to the target shareholders. This is known as a “transfer scheme”.

**Square Diagram:** There is one text box in each corner of the square. The top left hand box reads “Bidder”. There is a blue arrow (labelled ‘Consideration’) pointing from this box to the top right hand text box which reads “Target shareholders”. There is also a blue arrow pointing towards “Bidder” from “Target shareholders” labelled “Shares transferred to bidder”.

There is a line connecting “Target shareholders” to the bottom right hand text box which reads “Target company”. The line connecting the two text boxes is labelled “Original ownership relationship”.

There is then a red arrow pointing from “Target company” (the bottom right hand text box) to the bottom left hand text box which also reads “Target company”.

There is a line connecting the bottom left hand “Target company” to the top left hand text box “Bidder”. The line connecting the two is labelled “Ownership relationship following scheme”. **End of diagram.**

**Approval requirements for a scheme**

To be effective, the scheme must be approved at a court-convened meeting of target shareholders by:

* (1) a majority in number of target shareholders present and voting (in person or by proxy) (the “headcount” test); and
* (2) 75% in value of the shares of target shareholders present and voting (in person or by proxy) (the “value” test).

NB Any shares held by the bidder or persons connected with the bidder are excluded for the purpose of these calculations.

In addition to receiving the necessary target shareholder approvals, the scheme must be sanctioned by the High Court (the “Court”). Once the Court has sanctioned the scheme and the Court order has been delivered to the Registrar of Companies for registration, the scheme becomes binding on all the members, meaning that the bidder obtains 100% ownership of the target company (s.899(3) CA 2006). This ability to secure all of the shares in the target company is the key reason why a scheme of arrangement is the structure of choice for many bidders in a takeover situation.

**The importance of target board cooperation in a scheme**

Given that a scheme of arrangement is, by definition, an arrangement between the target company and its own shareholders, this structure is generally only suitable where the transaction is recommended by the target company board.

With the consent of the Panel, a bidder may switch from a contractual offer to a scheme of arrangement (or vice versa). Such a change must be announced in accordance with Section 8 of Appendix 7 to the Takeover Code.

**The Takeover Code and schemes of arrangement**

The Takeover Code regulates takeovers of relevant companies, however effected, including by means of scheme of arrangement (Section 3(b) of the Introduction to the Takeover Code). The Takeover Panel’s practice in applying the Takeover Code to schemes of arrangement has been codified in Appendix 7 of the Takeover Code.

The basic rule is that all provisions of the Takeover Code apply to an offer effected by means of a scheme in the same way as they apply to an offer effected by means of a contractual offer (Section 1 of Appendix 7) except to the extent that Appendix 7 applies. The most notable exceptions are Rule 10 (acceptance condition), Rule 31 (timing of the offer) and Rule 34 (right of withdrawal).

Note that Rule 2 on announcements applies in the same way to a scheme and to a traditional offer. Section 2 of Appendix 7 of the Takeover Code states that a mandatory offer under Rule 9 may not be satisfied by way of a scheme except with the prior consent of the Panel.

**Advantages of a scheme of arrangement**

A key advantage of a scheme of arrangement (when compared to a contractual offer) is that, once it has become effective, a scheme binds all of the target shareholders. This means that the bidder immediately acquires all of the target shares. It binds all shareholders, whether or not they voted in favour of the scheme, even if they purchased their shares after the court-convened meeting took place.

When it comes to the speed of the transaction, a bidder is likely to achieve 100% ownership of the target company more quickly by following the scheme route than by pursuing an offer. This is because, in a contractual offer, it is generally necessary for the bidder to undertake the compulsory acquisition procedure under s.979 CA 2006 in order to obtain full ownership of the target. The prescribed time intervals set out in this procedure mean that it generally takes longer overall to reach 100% than in a scheme of arrangement.

The scheme approval threshold (see above) that delivers a guaranteed 100% ownership is also easier to meet than the threshold for the compulsory acquisition procedure that would deliver 100% ownership in a contractual offer. (The compulsory acquisition threshold requires the acquisition of 90% in value of shares to which the contractual offer relates and 90% of the voting rights carried by those shares – see below).

A further benefit of acquiring 100% of the target shares is that the bidder immediately satisfies the 75% threshold needed to delist the company and take it private. This means that the target will generally be able to provide financial assistance in connection with a debt-funded bid more quickly than in a traditional offer (see below).

Finally, if the bidder wants to create a perception that the bid is more a merger of equals than a purchase by one company of another, a scheme of arrangement is more likely to give this impression since the target directors are more in control than in a contractual offer situation.

**Disadvantages of a scheme of arrangement**

The key disadvantage of undertaking a takeover by way of scheme is that, whereas a successful vote secures 100% ownership, an unsuccessful scheme will result in the bidder failing to secure any additional shares in the target company.

In addition, whilst the threshold to achieve 100% ownership in a scheme is easier to achieve than in a contractual offer, the threshold simply to declare an offer unconditional is much lower: it is 50% plus one share (including any shares already owned by the bidder in the target). For a bidder who is keen simply to secure control of a target (perhaps before another bidder is able to take it over), the most effective option is likely to be to pursue a contractual offer and purchase as many shares as it can as quickly as possible. Once it has achieved control of the target company and declared its offer unconditional, the bidder may choose to keep its offer open. In these circumstances, once they see that the bidder has taken control of the target, other shareholders are likely to accept the offer (even if they were not, originally supportive of it). As such, whilst a scheme is an “all or nothing” structure, a contractual offer can allow a bidder to reach full ownership by incremental steps.

The scheme timetable is less flexible because of this court involvement. It is more difficult and time-consuming to amend scheme documentation - for example, where the terms of the bid are to be revised or the bid improved - because new documentation would need to be approved by the Court and a new court meeting may be required. This, and the involvement of counsel, might make it more expensive than a contractual offer but, in most large takeovers, the final costs will be fairly similar whether it is a scheme or a contractual offer.

As discussed above, a scheme of arrangement cannot usually be used in a hostile offer, as it is the target company, not the bidder, which is proposing and entering into an arrangement with its members. In practice, the bidder therefore requires the cooperation of the target in order to be able to implement a scheme.

**Summary**

* A scheme of arrangement is a statutory procedure which is commonly used as a way to effect a takeover.
* The scheme itself is entered into between the target and its shareholders; the net effect is that the shares in the target are transferred to the bidder in return for payment of the consideration.
* A scheme of arrangement must be approved both by target company shareholders in a court-convened meeting and by the court itself.
* A major advantage of a scheme is that it delivers 100% ownership in the target.
* The Takeover Code applies to schemes except where it is disapplied. Appendix 7 sets out how the Takeover Code should be interpreted in a scheme.